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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 33

S. A. LYNCH, *et al.*,

Petitioners,

v.

ATLANTIC COAST LINE RAILROAD COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF FOR PETITIONERS.

J. TURNER BUTLER,
Graham Building,
Jacksonville, Florida,

FRED N. OLIVER,
WILLARD P. SCOTT,
110 East 42nd Street,
New York, N. Y.,

Attorneys for Petitioners.

Dated: September 22, 1953.

INDEX.

	PAGE
OPINIONS BELOW	1
JURISDICTION	2
STATUTES	2
STATEMENT	5
The 1948 Plan Proceedings	6
The 1951 Plan Proceedings Before the Commission	9
The 1951 Plan Proceedings Before the Courts Below	11
The Present Situation	12
The Position of the Lynch Interests	13
SPECIFICATION OF ERRORS	17
SUMMARY OF ARGUMENT	18
ARGUMENT	20
I. The Commission lacked power under Section 77(f) to require a merger of the debtor with Atlantic Coast Line as provided in the pending plan for the reason that it applied standards inconsistent with the provisions of the Interstate Commerce Act	20
1. The principle of the *Schwabacher* case is applicable here	20
2. The Commission refused to follow the *Schwabacher* case by refusing to give effect to unification savings	22
3. The refusal of the Commission to give effect to unification savings is shown by every applicable test	25
II. The Commission assumed an excess of authority in providing for an enforced merger of two separate properties on the same basis as though they had been parts of the same system	29
CONCLUSION	33

Table of Cases.

	PAGE
Atlantic Coast Line R. Co. v. *St. Joe Paper Company*, 179 F. (2d) 538	2, 7
Atlantic Coast Line Railroad Co. et al. v. *St. Joe Paper Co. et al.*, 339 U. S. 929	7
Crowell v. *Benson*, 285 U. S. 22, 62	28
Florida East Coast Railway Company Reorganization, 267 I. C. C. 295 and 729	2
Group of Institutional Investors v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, 570	29
In re Florida East Coast Railway Company, 81 F. Supp. 926	2, 7
In re Florida East Coast Railway Co., 52 F. Supp. 420, 424	6
In re Florida East Coast Ry. Co., 103 F. Supp. 825	12
Old Colony Bondholders v. *New York, N. H. & H. R. Co.* (C. C. A. 2d, 1947) 161 F. 2d, 413, cert. den. sub nom.	19, 29, 31, 32
Protective Committee for Bonds of Old Colony Railroad Co. v. *New York, New Haven & Hartford Railroad Co.* (1947) 331 U. S. 858, rehearing denied (1947) 332 U. S. 803	30
Schwabacher v. *United States*, 334 U. S. 182 (1947)	18, 20, 22, 23

Statutes.

Title U. S. Code, Sec. 1254	2
Bankruptcy Act, Section 77(f)	2, 5, 17, 18, 19, 22, 28, 32
Interstate Commerce Act, 49 U. S. C. A. §5	3

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The opinion of the Court of Appeals is reported in *Atlantic Coast Line Railroad Company v. St. Joe Paper Company*, 201 F. (2d) 325; R. Vol. II, 717*; the opinion of the District Court is reported in *In re Florida East Coast Railway Company*, 103 F. Supp. 825; R. Vol. I, 127; the decisions of the Interstate Commerce Commission relating to the 1951 plan here involved are reported in *Florida East Coast Railway Company Reorganization*, 282 I. C. C. 81 and 282 I. C. C. 195; R. Vol. I.

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* All references are to the record in No. 24, October Term, 1953.

The earlier decisions relating to the 1948 plan are reported as follows: opinion of the Court of Appeals, *Atlantic Coast Line R. Co.* v. *St. Joe Paper Company*, 179 F. (2d) 538; opinion of the District Court, *In re Florida East Coast Railway Company*, 81 F. Supp. 926; opinion of the Interstate Commerce Commission, *Florida East Coast Railway Company Reorganization*, 267 I. C. C. 295 and 729.

Jurisdiction.

The jurisdiction of this Court rests on Title 28, U. S. Code, Sec. 1254. The petition for certiorari was filed on April 8, 1953, and was granted by the Court on May 4, 1953. The order granting this and similar applications in Nos. 670, 705 and 710, October Term, 1952, provides that the petitions granted are "limited to question 1 presented by the petition for writ of certiorari in No. 670".

Statutes.

Fifth Sentence of Section 77(f) of the Bankruptcy Act.

(The So-Called "Consistency Clause")

(From 11 U. S. C. A. §205)

Upon confirmation of a plan, the Commission shall, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of chapter 1 of Title 49 as on August 27, 1935, or thereafter amended.

PORTION OF THE INTERSTATE COMMERCE ACT

(From 49 U. S. C. A. §5).

(2) (a) It shall be lawful, with the approval and authorization of the Commission, as provided in subdivision (b)—

(i) for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership; or for any carrier, or two or more carriers jointly, to purchase, lease, or contract to operate the properties, or any part thereof, of another; or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise; or for a person which is not a carrier to acquire control of two or more carriers through ownership of their stock or otherwise; or for a person which is not a carrier and which has control of one or more carriers to acquire control of another carrier through ownership of its stock or otherwise; or

(ii) for a carrier by railroad to acquire trackage rights over, or joint ownership in or joint use of, any railroad line or lines owned or operated by any other such carrier, and terminals incidental thereto.

(b) Whenever a transaction is proposed under subparagraph (a), the carrier or carriers or person seeking authority therefor shall present an application to the Commission, and thereupon the Commission shall notify the Governor of each State in which any part of the properties of the carriers involved in the proposed transaction is situated, and also such carriers and the applicant or applicants (and, in case carriers by motor vehicle are involved, the persons specified in section 305 (e)), and shall afford reasonable opportunity for interested parties to be heard. If the Commission shall consider it necessary in order to determine

whether the findings specified below may properly be made, it shall set said application for public hearing; and a public hearing shall be held in all cases where carriers by railroad are involved unless the Commission determines that a public hearing is not necessary in the public interest. If the Commission finds that, subject to such terms and conditions and such modifications as it shall find to be just and reasonable, the proposed transaction is within the scope of subparagraph (a) and will be consistent with the public interest, it shall enter an order approving and authorizing such transaction, upon the terms and conditions, and with the modifications, so found to be just and reasonable: Provided, That if a carrier by railroad subject to this chapter, or any person which is controlled by such a carrier, or affiliated therewith within the meaning of paragraph (6), is an applicant in the case of any such proposed transaction involving a motor carrier, the Commission shall not enter such an order unless it finds that the transaction proposed will be consistent with the public interest and will enable such carrier to use service by motor vehicle to public advantage in its operations and will not unduly restrain competition.

(c) In passing upon any proposed transaction under the provisions of this paragraph (2), the Commission shall give weight to the following considerations, among others: (1) the effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected.

Statement.

The Florida East Coast Railway started reorganization under Section 77 of the Bankruptcy Act later than most carriers which have sought to reorganize under that Act. Consequently the precedents arising from earlier cases were available. Also unlike most railroads in reorganization, its capital structure is without complications. Its unsecured debt is small and its stock is admittedly without value. It has two bond issues. The First Mortgage bonds are outstanding in a relatively small amount and all are agreed that they should be paid in full. The only class of security raising questions of proper treatment is that of the Refunding bonds, which are outstanding in the principal amount of $45,000,000. Unpaid interest increases the total claim to over $80,000,000.

Untroubled by the host of problems usually confronting a carrier in reorganization, with future earnings assured by the steady agricultural and industrial growth of the East Coast of Florida,[1] with its entire main line rebuilt and the rehabilitation program completed,[2] and with current cash balances far in excess of any foreseeable needs,[3] reorganization of the debtor should have been effected years past, but for one factor. That single factor impeding its reorganization, by diverting attention from all other questions of fair and equitable treatment, was, and is, the struggle for control and ultimate ownership of the reorganized company.

On the one hand, St. Joe Paper Company, which owns over a majority of the outstanding Refunding bonds, has

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[1] 282 I. C. C. at 106; R. II, 288-303; R. III, Lynch Exs. 2-A to 27-A inclusive.

[2] 282 I. C. C. at 111: R. II, 313.

[3] 282 I. C. C. at 169 *et seq.*

sought to assure to itself the control that might be expected to flow from its anticipated ownership of a majority of the stock issued in reorganization. On the other hand, Atlantic Coast Line Railroad Company, a connecting carrier and third party stranger, has persistently sought to acquire complete ownership of the debtor at as low a price as possible over the protest of the Refunding bondholders, who are the equitable owners of the property. This has dominated all other aspects of the proceeding since 1945 (179 F. 2d, at 544). It has led directly to the assumption by a majority of the Commission of the excess of power complained of by petitioners.

The question here presented has a two-fold aspect (1) the extent of the power conferred on the Commission by statute and (2) an ascertainment as to whether the conditions applicable to the exercise of the power have been met. A review of the pertinent facts not only sheds light on the peculiar circumstances under which the Commission has here attempted to exercise an excess of power, but is necessary in a consideration of the second phase of the question. This was expressly recognized by the Court of Appeals, on appeal from the 1948 plan, where that court said (179 F. 2d, at 544):

> "We agree with the trial judge that upon the facts of record and his findings, and in the light of this determination of the Commission, such a forced merger as is now proposed is contrary to the statute."

The 1948 Plan Proceedings.

The Commission's 1942 plan (252 I. C. C. 423 and 731) was disapproved by the District Court and referred back to the Commission, *In re Florida East Coast Railway Co.*, 52 F. Supp. 420, 424.

Further hearings were held. The Commission proposed its 1945 plan, in which it rejected an offer by Coast Line to acquire a large portion of the stock of the reorganized company, pointing out that since the securities proposed to be issued did not satisfy the claim of the Refunding bondholders, the latter must be given the entire equity in the reorganized company to provide for recoupment (261 I. C. C. 151, 192).

The Commission then received representations from Coast Line that control of the reorganized debtor by St. Joe Paper Company, a holder of a majority of the Refunding bonds, would not be in the public interest.

Further hearings were again held. After long preoccupation with the question of sale to Coast Line and without full consideration of the question of fair and equitable treatment, the Commission, by a split vote of 5 to 4, issued its 1947 plan. This provided for an enforced sale of the debtor's properties to Coast Line for a price of $40,500,000, payable partly in cash but principally in face amount of various classes of securities of Coast Line (267 I. C. C. 295). Following reargument and reconsideration, the Commission issued its 1948 plan of substantially similar effect, this time by a split vote of 6 to 5 (267 I. C. C. 927).

After hearings, Circuit Judge Sibley, sitting as District Judge designate, disapproved the plan, on the ground, among others, that it was unfair and inequitable, *In re Florida East Coast Railway Company*, 81 F. Supp. 926.

This disapproval was upheld by the Court of Appeals, *Atlantic Coast Line R. Co.* v. *St. Joe Paper Company*, 179 F. (2d) 538. An application by Atlantic Coast Line for a writ of certiorari was denied, *Atlantic Coast Line Railroad Co. et al.* v. *St. Joe Paper Co. et al.*, 339 U. S. 929.

The proceedings again went back to the Commission and Coast Line persisted in its attempts to acquire the debtor's

properties, with the consequent subordination of the new evidence relating to value and fair and equitable treatment. The prize involved in this continuing struggle between the two major parties for control or ownership is substantial. It includes ownership not only of the sole railroad on the East Coast of Florida, but control also of traffic routings, large bank accounts and a major enterprise in the territory. Unfortunately, this prolonged and bitter struggle has seriously affected the rights of others in two respects:

(a) In its preoccupation with the novel questions raised by contest over ultimate ownership, the Commission has repeatedly and almost completely disregarded the evidence of changed conditions concerning the earning power of the debtor; while to the extent that it has considered such evidence its conclusions reveal that mere "lip-service" was rendered.*

(b) Each of the contestants for control has sought, quite naturally, to keep the ultimate valuation or price fixed by the Commission as low as possible. Coast Line has attempted to purchase cheaply, while St. Joe Paper Company has sought the greatest flexibility for its future position as majority stockholder.

While these consequences were not unnatural, the inevitable effect was to divert attention from the fundamental standards of fair and equitable treatment. Instead there resulted an almost complete concentration on the conflict over ultimate ownership of the railroad, with a perfunctory discharge by the Commission of its other duties concerning the plan. Clearly, the Commission suffered from "a vision

* As the Court of Appeals said "taking note of its tremendous overemphasis on and the preoccupation of, the Commission with the struggle on the one hand of the St. Joe Paper Co., and on the other, of Coast Line for control of the debtor, with its subordination of the primary question of the legal and equitable rights of the bondholders • • •" (179 F. 2d, at 543).

foreshortened by a too intense regard of, and preoccupation with, the question of which should control the debtor" (179 F. 2d, at 542).

The situation was succinctly summarized by the Court of Appeals in its first review, where it was said (179 F. 2d, at 544):

> "The Commission has had these matters under consideration for now over a period of eight years, during which period the debtor's properties and condition have greatly improved. In that period the Commission has changed and vacillated, and vacillated and changed, and vacillated again, and now the majority, for reasons difficult to follow, seems to have developed an *idée fixe* that the only thing the Commission can do in the premises is to accept either the plan for Coast Line control or one for St. Joe control. Unwilling to vest control in St. Joe, and apparently closing its eyes to any other solution, it seems in desperation to have seized upon the Coast Line offer as its only way out."

The 1951 Plan Proceedings Before the Commission.

Hearings were again held before the Commission and the 1951 plan was adopted by a 6 to 3 vote.

This plan was substantially identical to the disapproved 1948 plan.* The principal difference was an increase of $6,125,000 in face amount of securities to be paid by Coast Line, less a decrease of $125,000 in cash, which was the entire recognition given to an increase of $800,000 in esti-

* A similar statement made in our petition for certiorari was characterized by Atlantic Coast Line as "not supported by the record." On the contrary, disregarding details such as a ¼% increase in interest rate or the $125,000 decrease in cash, the statement is fully supported by the record. Further substantiation is afforded by the Commission's own comparison, in tabular form, set forth in 282 I. C. C. at 162, see below.

mated earning power and to an annual credit of $462,000 for unification savings (282 I. C. C. at 158-160).

Commissioner Mahaffie, as in the earlier reports, wrote a dissenting opinion, joined in by others of the minority. He pointed out that the $6,000,000 net increase in face amount of Coast Line securities "accentuates the inherent unfairness of the plan" (282 I. C. C. at 190).

The Commission's own comparison of the differences between the 1948 and the 1951 plan is as follows (282 I. C. C. at 162):

	1948 Plan	1951 Plan
3½% fixed interest bonds	$13,500,000	—
3¾% fixed interest bonds	—	$14,000,000
4¼% income bonds	7,875,000	13,500,000
Preferred Stock	9,000,000	9,000,000
Common Stock	6,000,000	6,000,000
Cash	4,125,000	4,000,000
Total	$40,500,000	$46,500,000

The increase of $6,000,000 face amount of securities, most of which the Commission found would sell at 80% of par (282 I. C. C. at 162), is the entire recognition given in the 1951 plan to two major changes in conditions:

(a) The 1948 plan was based upon an estimate of $1,500,000 annual income available for interest, while the 1951 plan was based upon an estimate of $2,300,000 (282 I. C. C. at 101, 112), an increase of $800,000 per annum.

(b) The 1948 plan assumed no credit for unification savings resulting from a merger of the two carriers, while the 1951 plan found that the debtor should receive credit for such savings in the amount of $462,500 annually (282 I. C. C. at 159).

These two changes recognize an improvement in earning contribution of $1,262,000 annually, over and above

what was anticipated as the basis for the 1948 plan. As contrasted with the $1,500,000 earning capacity estimated as the basis for the 1948 plan, this represents an increase of 84% in earnings contributed to the merged enterprise, which should have been reflected in a similarly increased capitalization.

Nevertheless, the Commission majority in 1951 nullified their own finding of such a striking increase in earning power by increasing their valuation by less than 15% in face amount of Coast Line securities. Assuming, contrary to the Commission's findings, that those additional securities would be worth par, they would be paid for in full within a period of only five years out of the additional earning power now recognized by the Commission majority.

The fact that the Commission majority was thus impelled to ignore in large part its own findings when it came to fixing a purchase price that Coast Line could comfortably pay, shows the extent to which it was driven to disregard other factors by its preoccupation with ultimate ownership.

It was under these circumstances, with its "vision foreshortened", that the Commission majority attempted to exercise an excess of authority for the purpose of reaching its immediate objective in disposing of the question of ultimate ownership.

The 1951 Plan Proceedings Before the Courts Below.

After a week of hearings, Circuit Judge Strum, sitting as District Judge, concluded that the plan should be disapproved, the Section 77 proceedings dismissed and the equity proceedings reinstated (R. Vol. I, 168). The decision was accompanied by an extensive opinion which fully and clearly analyzed the evidence, the Commission's pro-

posals and the objections thereto (R. Vol. I, 127; *In re Florida East Coast Ry. Co.*, 103 F. Supp. 825). In essence, the District Court concluded, in the exercise of his informed discretion, that the 1951 plan retained "the basic inequities" for which the 1948 plan had been rejected (103 F. Supp. 825, 832; R. Vol. I, 137).

Although Judge Strum gave the plan a detailed and careful analysis and pointed out numerous defects (103 F. Supp. 825, 836 *et seq.*; R. Vol. I. 143 *et seq.*), he did not go into the question now before this Court. On the appeal from the 1948 plan, the Court of Appeals had said that a forced sale or merger might be lawfully certified and approved and confirmed (179 F. 2d, at 544). Judge Strum accepted this as the "law of the case" and did not consider the question (R. Vol. I. 140). Nor did the Court of Appeals.

By a 3 to 2 decision, the Court of Appeals reversed Judge Strum and directed that the plan be approved (201 F. 2d 325, 331; R. Vol. II). The majority opinion below is silent as to how the 1951 plan meets the defects of the 1948 plan condemned by the same court. It holds that the findings of the trial judge "are themselves without support in law or fact" (201 F. 2d, at 330). Reasons for this conclusion are not set forth.

The present situation.

The 1947 plan was contrary to the views of the examiner who heard the evidence (267 I. C. C. 295; R. Vol. VI 734). It was adopted by a bare majority of the Commission.

The 1948 plan, substantially identical to the 1947 plan, was adopted by a bare majority of the Commission (267 I. C. C. 927). It was disapproved by Circuit Judge Sibley, sitting as district judge designate and by two of the three Circuit judges who sat in review.

The 1951 plan is substantially identical to the 1947 and 1948 plans. Like the earlier plans, it was approved by a divided Commission. It was disapproved by Circuit Judge Strum, who has had charge of the proceedings since their inception. On appeal to the Court of Appeals, sitting *en banc*, three judges agreed with the majority of the Commission and two judges dissented.

To summarize, of those who have passed upon the pending plan or substantially identical earlier proposals, the trial examiner was opposed and a substantial minority of the Commission were opposed. Both trial judges were opposed and four circuit judges (including the two sitting as trial judges) have expressed opposition.

No security holder has supported the plan except for a small deposit committee which favored the 1948 plan and which has since withdrawn and disbanded. On the contrary, every Refunding bondholder represented in the proceeding, together with the Refunding mortgage trustee, expresses strong opposition to the plan.

Coast Line naturally supports the Commission plan which turns the properties over to it in an enforced sale despite the protests of all of the owners. As the Court of Appeals said earlier (179 F. 2d, at 542):

> "The case we have here is that of one railroad company coveting, and pressing to possess, a competing debtor railroad company, against the wishes of 98 per cent of the equitable owners of the debtor and over their violent objections, that consummation of the plan will result in depriving them of their property without just compensation."

The position of the Lynch interests.

Unfounded assertions by Coast Line before the court below appear to be the only basis for the statement in the

majority opinion, wholly unsupported insofar as the Lynch interests are concerned, to the effect that the bondholders are primarily concerned not with obtaining value received for their securities but with a conversion into title to the properties (201 F. 2d, at 330).

This basic misconception of the court below may have been responsible in large measure for the reversal of its earlier position. In its earlier opinion the court below pointed out that if opposition to the plan were based upon such irrelevancies as desire for control, it would not be valid and the plan should be approved, but that the evidence conclusively established that the minority were objecting in good faith and not seeking control (179 F. 2d, at 544).

In its last opinion, however, the court below has arrived at a diametrically opposed view, wholly unsupported by evidence. There has been no change in the position of the Lynch interests. That position is, and has been, that any plan should provide fair and equitable treatment for the minority, that if Coast Line were to acquire ownership it should not be permitted to do so at a bargain counter price and that if St. Joe Paper Company were to acquire control the minority should have representation on the board of directors. The Bondholders Agreement and agreed Plan of Reorganization annexed thereto, filed with the District Court, provided for such minority representation by giving the S. A. Lynch Corporation the right to designate two out of twenty-eight directors and by giving other minority interests the right to make designations. It seems to be generally overlooked that the same Plan gave the District Court the right to appoint all three voting trustees, of whom only one might be selected by St. Joe Paper Company (R. Vol. I, 25-39). Because there has been no change in the position of the Lynch interests, and consequently no evidence thereon in the record, we can only surmise that the

position of the court below was predicated upon unsupported assertions of Coast Line.

Only because of the possibly irreparable consequences of those unfounded and unwarranted assertions by Coast Line, do we pause to mention them here.

The Lynch interests have been in this proceeding since 1938, several years prior to the intervention of any other of the present Refunding bondholder interests and over seven years before intervention of Coast Line.

From the time of their entry into these proceedings until the present day, the sole motive of the Lynch interests has been that of obtaining fair and equitable treatment for the minority Refunding bondholders. Throughout the history of this case, all plans that have been proposed have been judged by the Lynch interests on the single criterion of whether they were fair and equitable. At each hearing they have introduced comprehensive evidence bearing upon proper valuation and fair and equitable treatment, which in each instance so impressed the acting district judge as to lead to disapproval of the Commission's plan, even though the effect of the evidence before the Commission was minimized by the latter's preoccupation with questions of control and ownership.

When, by the end of World War II, it became apparent that no fair plan was forthcoming from the then majority interests, the Lynch interests were instrumental in bringing Coast Line into the proceeding, in the expectation of attaining a fair and equitable plan through a fair offer from Coast Line. Events of the ensuing years have shown that Coast Line has failed and refused to make fair and equitable proposals. To each of the Coast Line proposals, the Lynch interests have applied the same test of fair and equitable treatment and have consistently rejected the proposals as failing to meet that standard.

Not once during the period from 1938 to November, 1951, the date of execution of the Bondholders Agreement, have the Lynch interests had a common interest with St. Joe Paper Company, either in this proceeding or outside of it. On the contrary, the entire record shows an active opposition by the Lynch interests to the St. Joe Paper Company proposals. In fact, at each hearing, including the last one before the Commission, there have been three entirely separate viewpoints presented, that of Coast Line, that of St. Joe Paper Company and that of the Lynch interests.

After the Commission certified its 1951 plan, it became apparent that a fair and equitable plan was not forthcoming from the Commission and that drastic action on the part of the bondholders was essential. Consequently on November 1, 1951, the Lynch interests joined with all other Refunding bondholder parties, including the mortgage trustee, in support of an agreed bondholders plan of reorganization to be presented in the reactivated equity proceeding, if the District Court were to dismiss the pending proceeding and reinstate the equity proceeding (R. Vol. I, 25). This was done for a single purpose, to sponsor a plan that provided fair and equitable treatment for the minority and the means for a speedy termination of the pending litigation. This was the first time that all bondholder groups had taken united action. This defensive step was forced by the action of the Commission in promulgating a plan that was confiscatory and contrary to the due process clause of the Fifth Amendment.

Specification of Errors.

The order granting the writ of certiorari limited the review to a single question, designated as "question 1 presented by the petition for writ of certiorari in No. 670".

This question was variously presented in that petition. It was first stated (at p. 2) as "whether amendments to the 1933 Act, made in 1935, do authorize forced mergers." It was again stated (at p. 3) as "The narrow question is therefore whether the mere transfer of the consistency clauses from subdivisions (b) and (e) to subdivision (f) altered the meaning of the clauses and gave to the Interstate Commerce Commission a power to force mergers, which was withheld from it under the Act of 1933." And it was finally stated (at p. 3) as whether the Commission had "power to propose and certify a plan of reorganization involving a consolidation or merger of the Florida East Coast Railway Company with Atlantic Coast Line, to which Florida East Coast Railway had not agreed."

Accordingly, it appears that the question for consideration by this Court is whether the Interstate Commerce Commission had the power to promulgate under Section 77 of the Bankruptcy Act the pending plan that provides for a compulsory merger of the debtor with an entirely separate railroad. It is the position of petitioners that the court below erred in holding that the Commission had such power.

Summary of Argument.

I. The Commission Lacked Power Under Section 77(f) to Require a Merger of the Debtor With Atlantic Coast Line, as Provided in the Pending Plan, for the Reason That It Applied Standards Inconsistent With the Provisions of the Interstate Commerce Act.

In *Schwabacher* v. *United States*, 334 U. S. 182 (1947), this Court held that under the provisions of the Interstate Commerce Act, the valuation process in a voluntary merger proceeding was so delicate as to require that the Commission take into account the value of appraisal rights under a state law even though such rights were not enforceable.

In the instant case, the Commission recognized, but refused to give effect to, the rule that in a merger each party is entitled to receive credit for its pro rata share of the ensuing unification economies or savings.

The Commission found that the debtor's share of unification savings was $462,000 annually, and that the capitalized value of these savings was $7,345,000. Despite this, it increased its valuation of the debtor by only $500,000 to reflect these savings. It consequently gave effect to little more than the equivalent of one year of unification savings.

In thus giving "lip-service" to the principle, but disregarding it in the application, the Commission ignored the standards required by the Interstate Commerce Act as interpreted by this Court.

In so doing it exceeded its power under Section 77(f) of the Bankruptcy Act and in disregard of the principles laid down in the *Schwabacher* case.

II. The Commission Assumed an Excess of Authority in Providing for an Enforced Merger of Two Separate Properties on the Same Basis as Though They Had Been Parts of the Same System.

In *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.* (1947) 161 F. (2d) 413, cert. den. 331 U. S. 858, the Court of Appeals for the Second Circuit held that there was a distinction between a merger of the constituent parts of a system and a merger of entirely separate entities, that the power of the Commission was more restricted in the latter case and that more exacting standards are applicable.

This distinction was not recognized by the Commission or by the court below in the instant case. Both tribunals treated the situation as though it involved no more than the compulsory merger of members of the same corporate family, instead of the compulsory merger of two corporate strangers. In so doing, the Commission assumed an exercise of excessive power not warranted by Section 77(f) and contrary to the Interstate Commerce Act.

Argument.

The narrow question of the effect of the transfer of the so-called "consistency clause" from subdivisions (b) and (c) to subdivision (f) in the 1935 amendments to Section 77 will be discussed, we understand, in the briefs of other petitioners. That phase of the question of the power of the Commission to require a merger in a Section 77 reorganization will not be treated in this brief.

In two other respects, however, it is submitted that the Commission assumed an excess of power in requiring a merger under the terms here proposed and the circumstances here present:

(a) The Commission failed to apply the standards that this Court has found required under the terms of the Interstate Commerce Act.

(b) The Commission mistakenly assumed, as did a majority of the Court of Appeals, that the same standards and presumptions are applicable in an enforced merger of two strangers as are applicable in a merger of subsidiary members of a single family of companies.

If either of these contentions is sound, it is evident that the Commission has no authority under the "consistency" clause of subdivision (f) to promulgate the pending plan requiring a merger.

I. The Commission lacked power under Section 77(f) to require a merger of the debtor with Atlantic Coast Line as provided in the pending plan for the reason that it applied standards inconsistent with the provisions of the Interstate Commerce Act.

1. The principle of the *Schwabacher* case is applicable here.

In *Schwabacher* v. *United States*, 334 U. S. 182 (1947), this Court dealt with the standards applicable to voluntary mergers under Section 5 of the Interstate Commerce Act. In holding that the Commission was not at liberty to renounce to state tribunals the determination of stockholders' rights, this Court also concluded that the Commission "must look for standards in passing on a voluntary merger only to the Interstate Commerce Act" (at p. 198). The opinion continues to state that "Apart from meeting the test of the public interest, the merger terms, as to stockholders, must be found to be just and reasonable" (at p. 198). This was amplified (at p. 199):

> "In appraising a stockholder's position in a merger as to justice and reasonableness, it is not the promise that a charter made to him but the current worth of that promise that governs, it is not what he once put into a constituent company but what value he is contributing to the merger that is to be made good."

Thus, it was emphasized that the criterion is "what value he is contributing to the merger."

The ultimate disposition of that case by the Court further emphasized the importance attached to "what value" is contributed and the extent to which the valuation process *must* be carried, in order to comply with the Interstate Commerce Act standards of "just and reasonable". The Court said that rights given by local law to dissenters are irrelevant except insofar as reflected in current values, for which dissenters are entitled to an equivalent (at p. 200), and that no rights or claims granted by state law survive the approved merger agreement (at p. 201). The Court then concluded (at pp. 201-202):

> "While the Commission has found that what the appellants are given in this plan is just and reasonable, the record indicates that it may have declined to consider these claims, even if they are found to have some effect on the intrinsic value of the stock, because it thought it lacked jurisdiction. Under these circumstances, we cannot be sure that in arriving at its conclusion that the plan was just and reasonable it did not exclude some factors that it should consider under the views set out in this opinion. We therefore reverse the judgment below and remand the case to the Commission for reconsideration under the principles herein expressed."

This conclusion clearly indicates the degree of delicacy required in a determination of "contributed value" under

the statutory standard of "just and reasonable" imposed by the Interstate Commerce Act. Not only must the Commission consider "past yield, present market value and future prospects" (at p. 200), but it must also consider any value attributable to rights under state law, even though it cannot consider such rights themselves.

So much did this Court require in order to assure consistency with the provisions and purposes of Section 5 of the Interstate Commerce Act in a voluntary merger.

Let us contrast with that requirement, what was actually done by the Commission in the involuntary or enforced merger plan in the instant case. Inasmuch as Section 77 (f) requires consistency "with the provisions and purposes" of the Interstate Commerce Act, it is evident that the standards required by the *Schwabacher* case are here applicable.

2. The Commission refused to follow the *Schwabacher* case by refusing to give effect to unification savings.

In connection with the 1948 plan, the Commission found, based upon voluminous evidence and days of testimony, that economies resulting from merger of the debtor and Coast Line would aggregate between $350,000 and $1,000,000 annually (267 I. C. C. at 325). The record also showed the customary practice of crediting each of the properties with one-half of the prospective unification savings (I. C. C. Transcript p. 2825). However, the Commission refused to take these savings into account in fixing a value for the debtor, on the ground that they were "eventual savings to be gradually attained in the future" (267 I. C. C. at 742).

As a result of disapproval of the 1948 plan, and further extensive hearings, the Commission changed its position in connection with the 1951 plan. It concluded (282 I. C. C. at 159):

> "In our fourth supplemental report we refused to increase the estimate of future normal year earnings because of the prospective savings for the reason that the record did not justify such an increase. From the record now before us, it appears that the savings averaging $925,000 may be expected in the near future. On the basis of the testimony of witness Gordon at an earlier hearing, we believe it fair to divide such prospective annual savings equally between the creditors of the debtor and the Coast Line, reflecting an annual savings of $462,000 which in some manner should be reflected in the price to be paid by the Coast Line for the property."

After reaching this clear and explicit conclusion, which accords with the test laid down in the *Schwabacher* case of "contributed value" in the merger, the Commission rejected a suggestion that these savings be capitalized at 5% and arrived at "a capitalization of the debtor's share of the savings at 6.3 per cent" (282 I. C. C. at 159-160).

These are the principles that the Commission found to be applicable. Had they been followed it is evident that capitalizing $462,000 at 6.3% would have added $7,345,000 to the value of the debtor's properties for merger purposes.

For some inexplicable reason this was not done.

Immediately preceding its discussion of unification savings referred to above, the Commission said (282 I. C. C. at 159):

> "We are of the view that the value at which the debtor's property should be acquired by the Coast Line is approximately $46,000,000 exclusive of equipment obligations and that the creditors of the debtor should receive under the plan cash and principal or stated amount of Coast Line securities totalling at least that amount. Whether there should be additional securities issued in recognition of prospective savings remains for determination".

The Commission thus fixed a value of $46,000,000 for the properties, separate and apart from unification savings. It then went on to find an additional value attributable to unification savings of $7,345,000, which should have provided a total value of $53,345,000 for merger purposes.

Instead the Commission concluded, without explanation, "that the value of the debtor's property in terms of Coast Line securities, including one-half of the prospective savings, is $46,500,000" (282 I. C. C. at 160), or an amount just $500,000 greater than the valuation given to the properties without regard to unification savings. In other words, it increased the overall valuation by an amount scarcely greater than the unification savings for one year, instead of their capitalized value of $7,345,000.

This failure to compensate for unification savings, despite the principles stated, was then pointed out to the Commission and in its Sixth Supplemental Report it attempted an explanation that, we submit, cannot be supported. It said (282 I. C. C. at 205):

> "* * * our report pointed out that our conclusions would reflect capitalization of the debtor's share of the earnings at 6.3 per cent. Such a rate would represent a total capitalization for one-half the savings amounting to approximately $7,340,000. Since the amount of the savings and the length of time which would elapse before they are realized is somewhat uncertain, it seemed proper that approximately two-thirds should be capitalized in Coast Line proposed income bonds and one-third in Coast Line common stock.
>
> The remaining securities and cash provided for in the plan reflected roughly the securities which would be received for the debtor's property, and which may be compared with the securities which would be received under an internal reorganization."

This assertion is wholly irreconcilable with the Commission's earlier conclusion that the properties were worth $46,000,000 in "cash and principal or stated amount of Coast Line securities" without any allowance for unification savings (282 I. C. C. at 159).

3. The refusal of the Commission to give effect to unification savings is shown by every applicable test.

If the assertion quoted were accepted as accurate and $7,340,000 in income bonds and common stock were allocated as compensation for unification savings, it is evident that deducting this from the total overall valuation of $46,500,000 would leave only $39,160,000 as compensation for the properties alone. This $39,160,000 is not only smaller than the amount that the Commission said should be paid in cash and face amount of Coast Line securities for the properties alone, but is even less than the $40,500,000 provided in the disapproved 1948 plan which contained no allowance for unification savings.

Again, the Commission's response, when this discrepancy was pointed out, was to dismiss it almost casually. It said (282 I. C. C. at 203-204):

> "Mere comparisons of total permissible capitalizations alone may give misleading answers. For instance, from a mere comparison of the $46,000,000 permissible capitalization found by us for the debtor under a hypothetical plan for an internal reorganization with $46,500,000 capitalization in Coast Line securities found by us as permissible in arriving at the compensation to be paid by the Coast Line for the debtor's properties and securities representing savings, it might appear that we had failed to give adequate effect to one-half of the average savings that will result from unification of the debtor's properties with the Coast Line. As previously

> pointed out there is a substantial difference not only in the character and quality of the securities to be paid by the Coast Line but also in the amount of such securities."

The Commission majority overlooked the fact that in the immediately preceding report it had been concluded that the properties, exclusive of unification savings, were worth $46,000,000 in cash and Coast Line securities "totalling at least that amount" (282 I. C. C. at 159). That this meant $46,000,000 of something more than mere paper is apparent from the paragraph immediately preceding this conclusion, in which the Commission rejected the offer of Coast Line totalling over $42,000,000 in cash and securities, stating that that offer did not compensate for the properties alone. Yet the difference between that offer and the ultimate value fixed by the Commission for both properties and unification savings, consisted of an increase of $500,000 in fixed interest bonds and $4,500,000 in income bonds and a decrease of $842,000 in cash (282 I. C. C. at 162).

The net effect is that while the Commission has properly stated the valuation principle applicable under the Interstate Commerce Act to any merger, it has thereafter given only lip service to the principle. The results reached demonstrate beyond question, we submit, that the Commission in fact failed and refused to apply the applicable standards and in so doing deprived the Refunding bondholders of the treatment to which they were entitled to the extent of almost $7,000,000.

That the Commission thus failed to act consistently with the standards required by the provisions of Section 5 of the Interstate Commerce Act may be demonstrated in yet another fashion.

The ostensible increase in price of $6,000,000 face amount of securities in the 1951 plan over the 1948 plan (disregarding for the moment all offsetting items) is the only source from which compensation can be found for the Commission's own finding of an $800,000 increase in earning power of the debtor alone, quite apart from unification savings. Such an amount of additional earnings, if capitalized at 5%, would increase the valuation by $16,000,000, or at 6% would give an increase of $13,300,000, as contrasted with the $6,000,000 given by the Commission. Since such compensation is clearly inadequate for even this admitted increase in earning power, it follows that nothing whatever can be left as compensation for unification savings.

Or to put it another way, if the Commission were right in its Sixth Supplemental Report that unification savings were compensated to the extent of $7,340,000 out of the total purchase price, then it necessarily follows that no compensation whatever is allowed for the increase in earning power of the debtor found by the Commission over its 1948 estimate. But even if no compensation were required for increased earning power, the increase in price or valuation over 1948 was still insufficient to cover unification savings. In the 1948 plan, when no credit for unification savings was given, the overall value was put at $40,500,000. The only increase in the 1951 plan was $500,000 in fixed interest bonds and $5,625,000 in income bonds, with a decrease of $125,000 in cash. The Commission found that the income bonds would be worth 80% of par (282 I. C. C. 162). Assuming par for the fixed interest bonds, the additional $6,125,000 in bonds of both kinds would actually be worth $5,000,000. Deducting the $125,000 decrease in cash would leave a net increase of $4,875,000 over the 1948 plan. Assuming further that there were no change whatever

between the 1948 and 1951 basic conditions and conclusions except as to unification savings, it is evident that savings worth $7,345,000 are not compensated for by an allowance of additional securities worth $4,875,000.

If, as it was held in the *Schwabacher* case, adherence to the standards imposed by the provisions of Section 5 of the Interstate Commerce Act requires the most delicate weighing of values in a voluntary merger, it would seem to follow that consistency with those standards would require no less in an involuntary merger under Section 77. And likewise, if the weighing of values in a voluntary merger requires that consideration be given to rights under state law that cannot themselves be availed of, it would seem to follow that at least equal consideration in an enforced merger is required for an element of value which is uniformly recognized as a major factor in any merger.

Unless and until this is done, it follows that the Commission is exercising an excess of authority in imposing a merger not consistent with the provisions of Section 5 of the Interstate Commerce Act and consequently contrary to Section 77(f).

Where, as here, the Commission's own reports show on their face, clearly and unequivocally, that the action taken was in disregard of, and wholly inconsistent with, the standards provided by the Interstate Commerce Act, despite the accurate statement of such standards in the reports, we submit that this Court should require no less than was required in the *Schwabacher* case, in order to obtain consistency with the provisions of that Act.

Indeed, to require less would render Section 77 itself subject to invalidation under the Fifth Amendment. As this Court said in *Crowell* v. *Benson*, 285 U. S. 22, 62:

> "When the validity of an act of the Congress is drawn in question, and even if a serious doubt of con-

stitutionality is raised, it is a cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided."

In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, 570, this Court pointed out the necessity of preventing the property of one interest from being "subtly appropriated to pay the claims of another while lip service is rendered the principle of priority".

In the instant case the appropriation is scarcely subtle. Application of the principles properly stated by the Commission would require payment by Coast Line of over $7,000,000 for unification savings contributed by the debtor. Instead the Commission requires payment of only $500,000. Clearly this constitutes an expropriation of the property of the Refunding bondholders for the benefit of Coast Line and is a taking of property without due process of law, contrary to the Fifth Amendment.

II. The Commission assumed an excess of authority in providing for an enforced merger of two separate properties on the same basis as though they had been parts of the same system.

Despite repeated urging to the contrary, the Commission consistently refused to regard the instant situation involving a forced sale to a third party stranger as in any way different from an enforced merger of the component parts of an existing system.

That particular question came before the Court of Appeals for the Second Circuit in *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.* (C. C. A. 2d, 1947) 161 F.

2d, 413, cert. den. sub nom. *Protective Committee for Bonds of Old Colony Railroad Co.* v. *New York, New Haven & Hartford Railroad Co.* (1947) 331 U. S. 858, rehearing denied (1947) 332 U. S. 803. In that case Old Colony Railroad Company, a subsidiary of New Haven, was in the same reorganization proceedings with the latter, and a joint plan was proposed, contemplating a consolidation. Old Colony had filed its petition requesting reorganization with New Haven and had also joined in the plan proposing consolidation. Old Colony bondholders opposed the plan on the ground that a proper valuation had not been made by the Commission because a sale was involved. The Court of Appeals denied this contention, on the ground that Old Colony was a subsidiary to be reorganized "as a part of the plan" of New Haven and that its properties are, "for the purposes of the plan, on the same footing with respect to the whole system as are lines securing a divisional mortgage of New Haven."

The Court of Appeals pointed out, however, that if a sale had been involved entirely different questions would have been presented. This portion of the opinion is of clear application to the present case (pp. 420-421):

> "• • • the appellant raises a number of objections to the Commission's appraisal. The first is that the finality of an appraisal by the Commission is limited to a true reorganization, that is, to one where the property for which the new securities are to be issued belongs to the debtor. Since in the case at bar the plan contemplates a sale of Old Colony assets to the reorganized New Haven, the appellant argues that the Commission could not lawfully proceed as it did, but must follow the doctrine applied in *First Nat. Bank* v. *Flershem*, 290 U. S. 504, 527, 54 S. Ct. 298, 308, 78 L. Ed. 465, 90 A.L.R. 391,

> • • • *It is true that if the transfer of Old Colony assets is like a judicial sale on foreclosure or execution, the Commission's appraisal was not valid. But we think it is not.* • • • *The 'transfer' is as much a part of a true reorganization as if the title to the assets had been in New Haven.* The statute itself so treats such a transaction, for section 77, sub. a, allows a subsidiary railroad corporation, such as Old Colony, to file a petition stating that 'it desires to effect a reorganization in connection with, or as a part of the plan of reorganization of' the principal debtor. The plan now under consideration adopted the second alternative because the Commission determined that integration of the two railroads is required in the interests of the public. • • • We agree with appellees' argument that *the properties of the Old Colony are, for purposes of the plan, on the same footing with respect to the whole system as are lines securing a divisional mortgage of New Haven.*" (Emphasis supplied.)

The sole ground on which the Court of Appeals there denied the contention that ordinary reorganization standards were not applicable, namely that Old Colony was a subsidiary in reorganization with the proposed transferee, New Haven, and in effect a division of New Haven, is clearly not present here. Coast Line is a third party stranger, having no relationship to the debtor. The forced sale proposed by the Commission cannot be distinguished, in practical effect, from a foreclosure, except that the plan here fixes a maximum price instead of an upset minimum price for the properties to be sold.

The majority of the Court of Appeals in the *Old Colony* case, consisting of Judges Learned Hand and Swan, held that there was a clear distinction between an enforced merger of two entirely separate corporations and of the

constituent parts of an existing system or corporate family and that the exacting standards applicable in the first case were not required in the latter.

Throughout the phase of the instant proceeding where purchase by Coast Line has been involved, the Commission has acted as though it were dealing with two segments of the same system rather than with two entirely separate and distinct entities, having no present corporate relationship to each other. In other words, the Commission has assumed the same authority and applied the same standards as though there were involved only the customary Section 77 reorganization with a system integration and merger of subsidiary companies.

As a matter of business judgment, it is evident that an enforced merger of two strangers involves quite different problems from those involved in a consolidation of the constituent members of an existing system. In one there is a rearrangement of securities in the same and related properties for distribution to those interested. In the other there is what amounts to an enforced and non-competitive sale to a wholly unrelated corporation against the wishes of those whose property rights are at stake. Likewise, it seems clear that the Commission's assumption of authority here is contrary to the decision in the *Old Colony* case. There the only reason that a majority of the Court of Appeals upheld the Commission was that a system unification was involved, it being expressly pointed out that different considerations would otherwise apply. Finally, the assumption by the Commission of authority to deal with the situation here on the same basis as though a system unification were involved is clearly contrary to the provisions of Section 5 of the Interstate Commerce Act.

Conclusion.

For the reasons stated, it is submitted that the Commission was lacking in power to promulgate the pending plan providing for the enforced merger of the debtor with Atlantic Coast Line, a third party stranger, and that the court below was in error in reversing the order of the District Court disapproving the plan. Since there is no reason to believe that, after six supplemental plans over a ten year period, the Commission is able to develop a plan in this proceeding that will comply with statutory standards, it is further submitted that the order below should be reversed and the order of the District Court disapproving the plan, dimissing the proceeding, and reopening the equity cause, should be reinstated in its entirety.

Respectfully submitted,

J. Turner Butler,
Graham Building,
Jacksonville, Florida,

Fred N. Oliver,
Willard P. Scott,
110 East 42nd Street,
New York, N. Y.,

Attorneys for Petitioners.

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